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COMMISSION ON TRANSNATIONAL CORPORATIONS
Intergovernmental Working Group of
Experts on International Standards
of Accounting and Reporting
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Agenda item 5

ADOPTION OF THE REPORT OF THE GROUP ON ITS TENTH SESSION

Draft report

Addendum

Rapporteur: L. Nelson Carvalho (Brazil)

II. PROGRAMME OF WORK OF THE INTERGOVERNMENTAL WORKING GROUP OF EXPERTS ON INTERNATIONAL STANDARDS OF ACCOUNTING AND REPORTING

A. Review of important current developments at the global and national level in the field of accounting and reporting by transnational corporations

1. The Secretary-General of the International Accounting Standards Committee (IASC) explained the role of that organization, which was founded in 1973, with the objective of facilitating the harmonization of accounting requirements for business enterprises. It sought to achieve that objective through the development and publication of international accounting standards. IASC has 105 member organizations and a Board comprising representatives from 12 countries drawn from the national accounting bodies and a consultative group which broadly represents users and preparers of financial statements. To date 31 standards have been issued.

2. He described progress on its comparability project (ED 32), which aims to reduce the options in its current standards. IASC has issued exposure drafts to revise its standards on research and development costs, inventories and the

capitalization of borrowing costs. The Board has approved for issue exposure drafts on revenue recognition, construction contracts, foreign exchange rates, business combinations and property, plant and equipment, which contains a limited reference to environmental expenditure. The Board intends to approve standards on cash flow statements in 1992 and on financial instruments in 1993. The Board's priorities include the revision of the existing standards on taxes and segmented information and the development of a standard on intangible assets. Lastly, the Secretary-General reported on the IASC project on financial reporting needed in developing and newly industrialized countries. That project was delayed but IASC now intends to send a questionnaire to appropriate bodies and to publish a report based on their responses. The questionnaire will help determine what IASC can do and how the comparability project will affect those countries. IASC realizes that one of the main needs of those countries was education and training and it is not an expert in that field. Therefore, it would support the efforts of the International Federation of Accountants (IFAC) and the Intergovernmental Working Group in that area.

3. In response to his statement, a number of experts asked about the IASC relationship with the International Organization of Securities Commissions (IOSCO). The Secretary-General replied that IOSCO sought the development of a set of mutually accepted standards for securities listings and that IASC hoped to provide those standards. He expected that a final decision on that matter would be taken in 1993. It was asked whether IASC intended to develop two sets of standards, one for listed companies and another for non-listed companies. The Secretary-General replied that the intention was to develop one set of common standards but, as always, some issues might be limited to particular types of enterprises. On the question of the Steering Committee on the Financial Needs of Developing Countries and Newly Industrialized Countries, an observer, in his capacity as Chairman of that Committee, expressed his dismay at the delay in its work, which resulted from three sources: (a) the lack of agreement between the Board and the Committee on its mandate, (b) the difficulty in agreeing on the real reasons for the lack of participation of developing countries in standard-setting and (c) the other priorities of IASC. He stated that he was not satisfied with the situation and that the Committee should either meet or be dissolved. In reply, the Secretary-General apologized for the delay and said the project should have the priority it deserves.

4. Although in formal terms the scope of IASC was not to enforce accounting standards, its cooperation with IOSCO and its assistance to developing countries and to countries in transition might put IASC in a de facto mandatory position. In view of that development, several experts asked whether it was acceptable that a private sector organization should play such an important role without having a political mandate. It was noted that IASC, together with IFAC, influenced most efforts for harmonization in that area and, therefore, both should be commended for their activities. But to avoid any misunderstanding in the report, it should be made clear that IASC and IFAC are private sector organizations that do not have the mandate to make their standards mandatory.

5. Some experts drew attention to the fact that the present action of IASC to exclude options was moving that body in the direction of putting more emphasis on investors rather than on the protection of creditors. That could easily lead to overemphasizing the short term and to overlooking long-term problems. Consequently, the elimination of options could be harmful for the economy of a country. As concerns, for example, Germany, it would then be forced to give up its concept of accounting and its interpretation of the prudence principle. So far, such options were permitted by the Economic Community, the Organisation for Economic Cooperation and Development and the United Nations.

6. Other experts raised the possibility of a conflict of interest between the professional aims of the people effectively involved in IASC and IFAC operations and the public interest. About 75 per cent of the audits of listed companies were done by the Big Six accounting firms. Several experts, however, noted that IASC was not exclusively composed of members of audit firms, that it looked to the interest of all countries and that both developed and developing countries used international accounting standards as models or appropriate benchmarks. Some experts expressed the opinion that the task of standard-setting should not be left entirely to private sector organizations of the auditing profession. In particular, where two or more technical methods were possible, the elimination of options must be decided by Governments or intergovernmental organizations under political control. In concluding the discussion, it was proposed that the Group should determine the extent to which the Group could endorse international standards without harming various national interests.

7. In concluding the discussion on global and national developments, the expert from the Russian Federation said that, although her country had recently revised its chart of accounts to comply with some international standards, there would be great difficulty in implementing it. She wondered whether the new financial statements that would be produced using accrual accounting would really reflect a true and fair view of the enterprise's situation. At the present time, enterprises did not have any assurance that they could ultimately collect their accounts receivable because of the economic chaos, the breakdown of the financial system, the severing of previous business relationships and the lack of experience of operating in a market economy. Those factors were dramatically increasing late payments or non-payments so that 80 per cent of the accounts might be in default. The problem of bad debts could be solved by making provisions for such bad debts but that practice had not yet been incorporated into the new chart of accounts. In addition, she wondered whether the tax authorities would accept such a practice. She concluded by saying that in applying international standards to countries in transition, the particular circumstances of the countries should be considered so that international economic relations were not damaged.

8. The expert from Czechoslovakia stated that, in the case of accrual accounting, there appeared to be a conflict between financial accounting requirements and tax law in his country. Tax law did not allow provisions for

bad debts. If a large per cent of accounts receivable were not collectible, there was a danger that enterprises would have to pay taxes on such uncollectible revenues. Fortunately, the tax authorities worked out that problem with the enterprises and did not collect taxes on that basis. In 1993, it would be possible to make provisions for bad debts. The expert from Poland stated that it was impossible to adopt international standards overnight. It must be done gradually since those standards were developed for stable economic and legal environments. The expert from Bulgaria agreed that the changes in the accounting system would take five or six years and new accounting legislation should give greater freedom to enterprises in their development of accounting systems. There was a problem in tax accounting in that it changed the accounting system results.

9. One expert from a developed country suggested that if there were difficulties or restrictions in applying international standards, then one solution would be to disclose the additional information in the notes to the financial statements. In referring to the issue of bad debts, the expert from Germany noted that the problem did not arise in planned economies, as accounts receivable were always paid for by the Government or other State organizations. If those receivables were recognized, they should be written down. He agreed that, if such doubtful accounts receivable were considered as assets without any value adjustment, then those financial statements would not be very meaningful. In Hungary, outstanding debts were evaluated at the end of the year and there was a possibility of creating a provision that could be deducted from taxes. However, tax law does not allow all provisions to be deducted in one year.

10. The representative of the European Community described recent activities of the European Accounting Advisory Forum, which was composed of representatives of national accounting standard-setting bodies and of other bodies that represent users and preparers. The main objective of the Forum was to find technical solutions for problems that had not yet been dealt with in the EC accounting directives in order to increase comparability. Current topics being discussed by the Forum include foreign currency translation, government grants and leasing. The subject of foreign currency translation was difficult owing to the link between financial accounting and taxation. While the problems might not be solved on the level of the individual accounts, they might be resolved on the level of the consolidated accounts, where there was no conflict between financial accounting rules and tax law, since taxes were based on the individual accounts. Regarding leasing, there were basically two approaches to the treatment of a lease where the lessee assumes the economic risks of the contract, and the Forum was trying to bring about comparability between those two approaches. The documents would be made available soon.

11. One expert asked what the European Community was doing on environmental accounting. The representative replied that the Commission of EC had published its Fifth Action Programme on the Environment, entitled Towards Sustainability, which contained a list of measures in the area of environmental action. It was considered necessary to include in the Programme some initiatives in the area of financial disclosure, but there were no

concrete proposals yet. It was doubtful whether proposals would be produced before the end of 1992.

12. He also elaborated on the Council Directive of 13 December 1991 on the annual accounts and consolidated accounts of insurance undertakings, which must be implemented by member States before 1 January 1994. That Directive would allow insurance companies to state their investments at the higher market value and to include the unrealized gains into the profit and loss account, provided that the historical cost amounts were shown in the rates. Replying to questions from other experts, he explained that, in most member States of EC, there was a linkage between the accounts prepared for commercial purposes and the accounts prepared for tax purposes and that, at the moment, there were only a few conflicts between the EC accounting directives and the international accounting standards. Should there be a conflict, companies must comply with their national law based upon the EC directive.